Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In re Applications of	)	
	)	
Sprint Corporation, Transferor	)	CC Docket No. 99-333
and	)	
MCI WorldCom, Inc., Transferee	)	
	)	
for Consent to Transfer Control	)	
of Corporations Holding Commission	)	
Licenses and Authorizations Pursuant	)	
to Sections 214 and 310(d) of the	)	
Communications Act and Parts 1,	)	
21, 24, 25, 63, 73, 78, 90, and 101	)	

Petition to Deny or to Impose Conditions of Communications Workers of America

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Table of Contents

Appendices

Summary

The proposed merger between MCI WorldCom and Sprint is not in the public interest. The proposed merger would remove an important competitor from the long distance and Internet markets; create anti-competitive concentrations in the long distance and Internet markets that could lead to increased prices, reduced services, and less innovation; effectively limit consumer and larger business choices for long distance service to a Big Two; and trap Sprint's primarily rural customers in its local exchanges into a continued downward spiral of company neglect (including service-affecting employment cuts and subsidization of other services from local service revenues).

The proposed merger would result in the following serious and irreversible harm to competition and the public interest:

(1) A Duopoly in Long Distance: Anti-Competitive Effects Harming Consumers and Larger Business

The proposed merger would combine the second and third largest long distance carriers, resulting in a long distance duopoly with the Big Two controlling 80 percent of the market. The merged entity would have the power and incentive to raise prices or degrade service at anti-competitive levels in both the consumer and larger business markets. RBOC entry into the long distance market is not "timely, likely, or sufficient" to offset the anti-competitive impact of the proposed merger in the two-year time frame of this merger review.

(2) Creation of a Dominant Internet Backbone: Threatens Internet Competition and Growth

The proposed merger would also disrupt the dynamic competition that is driving Internet growth, resulting in one dominant Internet backbone carrier whose 50 percent market

share would give it the ability to raise the price or degrade the quality of interconnection to its dominant backbone. Under similar market conditions, the U.S. Department of Justice and the European Commission required MCI to divest its entire Internet business as a condition for approval of the MCI WorldCom merger. However, that remedy has failed to achieve its stated goal to create another viable Internet backbone competitor. MCI sold its Internet business to Cable & Wireless. Cable & Wireless' Internet market share today is under 10 percent compared to MCI Internet's pre-divestiture market share of 40 percent.

(3) Employment Cuts: Adverse Impact on the Provision of High-Quality Long Distance and Local Services

The proposed merger would likely result in employment cuts that would negatively impact the quality of telecommunications services in local and long distance markets. After the MCI WorldCom merger, MCI laid off 3,750 employees, despite statements to the Commission that the merger would create jobs. Customers report eroding service at MCI WorldCom as a result of these job cuts. The applicants state there will be headcount reductions after the MCI WorldCom/Sprint merger. These job cuts are likely to be very large to achieve the projected $1.3 billion first-year post-merger savings in sales, general, and administrative costs.

To counteract these significant public interest harms, the Applicants fail to make their case that there are verifiable and demonstrable merger-related public interest benefits. The Applicants base their case on vague commitments that the proposed merger will increase consumer choice in residential and small business local markets with "all distance" packages of services. But the Applicants fail to provide the Commission with specifics in terms of investment dollars, markets, customer groups, and timetables for this increased investment.

The best test of the Applicants' claim that the merger will lead to improved service, customer choice, and accelerated deployment of broadband services to residential and small business customers is to look at the Applicants' post-merger commitments in the local exchange markets where they currently service residential and small business customers — Sprint's local telecommunications division. Sprint’s local telecommunications division serves 7.9 million primarily rural customers in 18 states. The Applicants are virtually silent as to the benefits the merger will bring to its local exchange markets serving customers who are “have-nots” on the wrong side of the digital divide. The Applicants provide no evidence that they intend to invest in infrastructure to improve service and bring the benefits of high-speed access to the Internet to this group.

Instead, the Applicants cite their planned development of fixed wireless (MMDS) as the central benefit of the proposed merger for consumers. But the Applicants overstate the promise of MMDS technology, which has not yet been market tested, is still too expensive for the mass market, and is not capable of providing voice communications. The Applicants provide the Commission with no evidence that the merged entity would accelerate investment in MMDS above the level that each Applicant had planned to make prior to the merger announcement.

It is possible that in the course of this merger review the Commission and the Applicants might reach agreement on conditions that would remedy the anti-competitive harm that would result from the proposed merger in the Internet backbone and long distance markets. Such a remedy would require the Applicants to agree to a full and complete divestiture of Sprint’s integrated long distance and Internet backbone facilities and business, with strong enforcement mechanisms in place. It is also possible that the Commission and the Applicants could reach agreement on conditions that would protect consumers against decline in telecommunications service that would result from post-merger employment cuts. Finally, it is possible that the Commission and the

Applicants could reach agreement on conditions that would ensure that residential and small business consumers receive concrete benefits from the merger in local exchange markets, with a particular focus on closing the digital divide in Sprint's largely rural local exchange service areas. However, absent conditions in all these areas, tied to strong enforcement mechanisms, the proposed MCI WorldCom/Sprint merger would result in significant and immediate consumer and competitive harms across the Internet, long distance, and local service markets. The Applicants have failed to prove any remotely reasonable or demonstrable evidence that the merger is in the public interest--far below the preponderance of evidence standard of the Commission. Therefore, the Commission should deny the Applicants' merger request.

I. Introduction

The Communications Workers of America (CWA) represents 630,000 people nationally, including more than 5,000 employees who work in Sprint's local telecommunications division in 12 of the 18 states where Sprint has local operations. Nationally, CWA members work in telecommunications (local, long distance, wireless, Internet), printing, publishing, broadcasting, cable, airlines, higher education, and state and local government, and for other public and private sector organizations. CWA members are also consumers of telecommunications services.

The proposed merger is not in the public interest. It would remove an important competitor from the long distance and Internet markets; create anti-competitive concentrations in the long distance and Internet markets that could lead to increased prices and reduced services and innovation; effectively limit consumer and larger business' choices for long distance services; and trap Sprint's primarily rural customers in its local exchange markets in a continued downward spiral of poor service.

The Applicants fail to prove that there are any merger-related public interest benefits to tip the balance. The Applicants make no commitments to improve service in Sprint's local exchange markets; they overstate the promise of MMDS technology and do not demonstrate that it is a merger-related benefit; and they do not provide concrete evidence that the merger will benefit residential and small business customers in competitive local exchange markets.

In short, the Applicants fail to demonstrate with a preponderance of the evidence that the merger is in the public interest. Absent conditions in all areas, the Commission should deny the Applicants' merger request.

II. Merger Review Legal Framework

Pursuant to sections 214(a) and 310(d) of the Communications Act, the Commission must determine that a proposed merger is in the public interest.[1] The Applicants bear the burden of proving, by a preponderance of the evidence, that the proposed transaction serves the public interest.[2] The Commission must weigh the potential public interest harms of the proposed transaction against the potential public interest benefits to ensure that the Applicants have shown that the merger, on balance, serves the public interest.[3] The Commission uses a "balancing process" that weighs probable public interest harms against probable public interest benefits. As harms to the public interest become greater and more certain, the degree and certainty of the public interest benefits must also increase commensurately in order for the Commission to determine that the transaction serves the public interest.[4] For some mergers, the harm to

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[1] 47 U.S.C. §§ 214(a), 303(r), 310(d).

[2] *In re Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules,* CC Docket No. 98-141, Memorandum Opinion and Order at ¶ 48 (Oct. 8, 1999 Rel.) (*SBC/AMT Order). See also Application of WorldCom, Inc. and MCI Communications Corporation For Transfer of Control of MCI Communications Corporation to WorldCom, Inc.,* CC Docket No. 97-211, Memorandum Opinion and Order at ¶ 10 (Sept. 14, 1998 Rel) (*WorldCom/MCI Order); Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries,* File No. NSD-L-96-10, Memorandum Opinion and Order at ¶ 32 (Aug. 14, 1997 Rel.) (*Bell Atlantic/NYNEX Order).*

[3] *SBC/AMT Order* at ¶ 46 and ¶ 48; *Bell Atlantic/NYNEX Order* at ¶ 10.

[4] *SBC/AMT Order* at ¶ 256; *Bell Atlantic/NYNEX Order* at ¶ 157.

competition may be so significant that it cannot be offset sufficiently by pro-competitive commitments or efficiencies.[5] Public interest benefits must be demonstrable, verifiable, and merger-related.[6]

The Commission's public interest standard is a broad and flexible one. It encompasses the "broad aims of the Communications Act," including, among other things, the implementation of Congress' pro-competitive, deregulatory national policy framework, the preservation and advancement of universal service, and the accelerated deployment of advanced services.[7] The

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[5] *Bell Atlantic/NYNEX Order* at ¶ 15.

[6] *SBC/AMT Order* at ¶ 255.

[7] *Id.* at ¶ 50; *In the Matter of Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc*., Memorandum Opinion and Order, CC Docket 97-211 (Sept. 14, 1998)at ¶ 9 *(WorldCom/MCI Order).*

public interest review may also assess whether the merger will affect the quality of telecommunications services[8] and service-affecting employment.[9]

As CWA demonstrates below, absent extensive conditions, the proposed merger poses serious anti-competitive harm and few, if any, merger-related public interest benefits for residential and small business consumers.

III. Analysis of Public Interest Harm

A. The Merger Will Result in Anti-Competitive Harm in Long Distance Markets

The proposed merger would combine the second and third largest long distance companies in an already concentrated market. The merged entity would have the ability to raise prices, reduce output, or degrade quality through unilateral or coordinated action. This would create a negative consequence for consumers and businesses.

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[8] *Id*.

[9] In the *WorldCom/MCI Order*, the Commission took under consideration the impact of that merger on employment. *See WorldCom/MCI Order* at ¶ 213. In the *SBC/AMT Order*, the Commission cited SBC's commitment to "improving service quality by hiring more employees." *See SBC/AMT Order* at ¶ 567. In the Telephone Authority/GTE Merger, the Commission also cited employee commitments as a merger-related public interest benefit. *See In re Applications of Puerto Rico Telephone Authority, Transferor, and GTE Holdings (Puerto Rico) LLC, Transferee, or Consent to Transfer Control of Licenses and Authorization Held by Puerto Rico Telephone Company and Celulares Telefonica, Inc.*, Files No. 03373-03384-CL-TC-98, 50516-50517-CW-TC-98, 0000001430, 22760-22761-CR-TC-98, 9713708, 9713707, 910998, 1330-DSE-TC-98, ITC-T/C-19980902-00605, Memorandum Opinion and Order at ¶ 57 (Feb. 12, 1999) (*Puerto Rico/GTE Order*).

When MCI merged with WorldCom last year, FCC Chairman William E. Kennard warned:

> Once this merger is consummated, the industry will again be posed just a merger away from undue concentration. I daresay that any subsequent merger - of this or similar magnitude - between long distance firms in the near future should be judged quite differently than the merger before us today.[10]

[10] Press Statement of FCC Chairman William E. Kennard on Merger of WorldCom and MCI (Sept. 14, 1998).

The proposed merger between MCI WorldCom and Sprint is of far greater magnitude than the merger between MCI and WorldCom. Moreover, it raises different and far more troubling competition issues in the long distance market. WorldCom's long distance business was primarily as a provider of wholesale services to resellers and business customers; its residential customer base was small.[11] Sprint has a significant retail presence in the consumer and larger business markets. WorldCom did not have the capability of providing a full package of advanced services to high-end business customers; Sprint along with AT&T and MCI are the only three carriers that have this capability.[12] The MCI/WorldCom merger resulted in a merged entity with 25.6 percent market share in a market dominated by the Big Three; the proposed MCI WorldCom/Sprint merger would result in a merged entity with 36.1 percent market share in a market dominated by the Big Two.[13]

It is no wonder, then, that Chairman William E. Kennard reacted with concern to the MCI WorldCom/Sprint merger proposal:

> American consumers are enjoying the lowest long distance rates in history and the lowest Internet rates in the world for one reason: competition. Competition has produced a price war in the long distance market. This merger appears to be a surrender. How can this be good for consumers? The parties will bear a heavy burden to show how consumers would be better off.[14]

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[11] *WorldCom/MCI Order* at ¶ 34.

[12] *Id.* at ¶ 34.

[13] FCC, *Trends in Telephone Service*, Industry Analysis Division of Common Carrier Bureau, Table 11.2 (Sept. 1999) (*Trends in Telephone Service).*

[14] Statement of FCC Chairman William E. Kennard on Proposed Merger of MCI WorldCom, Inc. and Sprint Corp., Oct. 5, 1999.

Indeed, the evidence is overwhelming that the proposed merger will result in anti-competitive harm to long distance consumers.

1. Relevant Market

The Commission has identified two relevant markets in domestic, interstate, interexchange services for competitive analysis, reflecting customer groups with different patterns of demand: (1) residential customers and small business (mass market); and (2) medium-sized and large business customers (larger business market).[15] The Commission has also identified the long distance market as a single national market.[16] We agree with the Commission's finding in the *Bell Atlantic/NYNEX Order* that the market for bundled long distance and local service is still a nascent market[17] and not relevant for competitive analysis in the context of this merger review.[18]

2. Market Participants

There are three most significant market participants in both the mass and larger business long distance markets. Together, AT&T, MCI WorldCom, and Sprint have 79.1 percent of the total

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[15] *WorldCom/MCI Order at* ¶¶ 24-25. *See also Bell Atlantic/NYNEX Order* at ¶ 53.

[16] *Id.* at ¶ 30.

[17] *Bell Atlantic/NYNEX Order* at ¶ 52.

[18] We acknowledge that there are other long distance product markets, such as the wholesale long distance product market, but we focus our discussion here only on the mass market and larger business market.

long distance market (based on total 1998 toll service revenues of long distance carriers).[19] No other long distance carrier has more than 2 percent market share.[20]

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[19] *Trends in Telephone Service,* Table 11.2.

[20] *Id.*

We focus on the "most significant market participants" because they are the ones that have "the greatest capabilities and incentives to compete most effectively" in the marketplace.[21] The Commission has stated that the loss of one participant in a market is likely to have a competitive effect "if the number of similar (*i.e. most significant)* market participants" is small.[22] There are today only three "most significant market participants" in the long distance market. Therefore, identification of the most significant market participants is central to a competitive analysis of the impact of the proposed merger in the long distance market.

According to the FCC, overall long distance market share (based on total 1998 toll service revenues of long distance carriers) is as follows: AT&T (43 percent), MCI WorldCom (25.6 percent), and Sprint (10.5 percent). Post-merger, the market will be a classic duopoly dominated by AT&T with 43 percent and MCI WorldCom/Sprint with 36.1 percent.[23]

Residential and Small Business Market. FCC data does not track the "small business" long distance market. In the residential market, AT&T, MCI WorldCom, and Sprint are the three most significant market participants. A merged MCI WorldCom/Sprint would have 24.1 percent of the

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[21] *Bell Atlantic/NYNEX Order* at ¶ 62.

[22] *Id.* at ¶ 65.

[23] *Id.*

residential market in a market in which the Big Two would dominate with 82.4 percent of the total market.[24] (*See* Tables 1 and 2.)

[24] *Trends in Telephone Service*, Table 11.5.

Larger Business Market. AT&T, MCI WorldCom, and Sprint also dominate the larger business market. A merged MCI WorldCom/Sprint would have 38.8 percent of this market, AT&T would have a roughly equal share with 39.4 percent.[25] (*See* Tables 1 and 2.)

In the high-end large business market for ATM and Frame Relay Services, there are virtually no substitutes for AT&T, MCI WorldCom, and Sprint, with respective market shares of 45.6 percent, 26.8 percent, and 20.5 percent for a total combined market share of 92.8 percent.[26] The Commission concluded in the *WorldCom/MCI Order that* "as businesses demand ever more sophisticated service offerings, the number of providers diminishes and that only AT&T, MCI and Sprint provide high-end services on a retail basis."[27]

[25] Dataquest, "Public Telecommunications Services North America Market Share and Forecast" (1999) as proved in Statement of James F. Rill, Hearing on Issues Relating to the Proposed MCI WorldCom/Sprint Merger, U.S. Senate Committee on the Judiciary (Nov. 4, 1999).

[26] ATM services revenues: AT&T: 36.6%, MCI WorldCom 32.9%, Sprint 29.1%, Other 1.4%. Total revenues $295.3 million. Frame Relay services revenues: AT&T 46.8%, MCI WorldCom 26.5%, Sprint 20%, Other 6.7%. Total revenues $3.6 billion. The market share figures we cite combine ATM and Frame Relay revenues. "Users Blast WorldCom Merger," *Network Fusion* (Oct. 11, 1999) based on data from IDC, MCI WorldCom, Sprint (available at http://www.nwfusion.com/news/1999/1011/mciworld.htm).

[27] *WorldCom/MCI Order* at ¶ 94.

Table 1. Pre-Merger Long Distance Market Share, 1998 based on toll service revenues of long distance carriers			
	Total LD Mkt	**Residential LD Mkt**	**Lg Business LD Mkt**
AT&T	43.0 percent	58.3 percent	39.4 percent
MCI WorldCom	25.6 percent	18.4 percent	27.6 percent
Sprint	10.5 percent	5.7 percent	11.2 percent
Total	79.1 percent	82.4 percent	78.2 percent

Sources: FCC, *Trends in Telephone Service,* Industry Analysis Division of Common Carrier Bureau, Table 11.2 and 11.5; Statement of James F. Rill, Hearing on Issues Relating to the Proposed MCI WorldCom/Sprint Merger, U.S. Senate Committee on the Judiciary, Nov. 4, 1999 from Dataquest, Public Telecommunications Services North America Market Share and Forecast, 1999.

Table 2. Post-Merger Long Distance Market Share based on toll service revenues of long distance carriers			
	Total LD Mkt	**Residential LD Mkt**	**Lg Business LD Mkt**
AT&T	43.0 percent	58.3 percent	39.4 percent
MCI WorldCom-Sprint	36.1 percent	24.1 percent	38.8 percent
Total	79.1 percent	82.4 percent	78.2 percent

Sources: FCC, *Trends in Telephone Service,* Industry Analysis Division of Common Carrier Bureau, Table 11.2 and 11.5; Statement of James F. Rill, Hearing on Issues Relating to the Proposed MCI WorldCom/Sprint Merger, U.S. Senate Committee on the Judiciary, Nov. 4, 1999 from Dataquest, Public Telecommunications Services North America Market Share and Forecast, 1999.

3. Analysis of Competitive Effects

With the removal of one of only three significant market participants, a combined MCI WorldCom/Sprint would have the market power through unilateral, coordinated, or tacit action with the single remaining significant market participant to raise prices, degrade quality, or delay innovation at levels inconsistent with a competitive marketplace. Both mass market and larger business customers would have no alternative, and would face escalating prices, a degradation in customer service, and fewer service options.

As there are significant barriers to entry in the mass market, this increase in market power would reduce choice for consumers and therefore significantly reduce anti-competitive constraint in the long distance market. The Commission has identified brand recognition as an important component of market success in the mass market. The Big Three spend more than $3 billion annually in advertising to maintain brand recognition, including the critical importance of a strong brand to attaining more than *di minimus* market share in the mass market. In the larger business market for high-end services, there are no alternatives to the Big Three. These factors remain powerful barriers to entry in the long distance consumer and larger business markets, despite the Commission's market-opening, deregulatory policies that have resulted in enormous expansion in long distance transmission capacity.

a. HHI Indices

The U.S. Department of Justice (DOJ) uses the Herfindahl-Hirschmann Index (HHI) to measure market concentration. The DOJ *Horizontal Merger Guidelines* consider any market with an HHI above 1800 to be "highly concentrated" and an HHI increase of more than 100 points "likely to create or enhance market power or facilitate its exercise."[28]

HHI analysis reveals that all relevant long distance product markets are highly concentrated, with pre- and post-merger HHI's well above 1800. Further, the proposed merger creates a presumption of market power in all relevant long distance product markets, with the increase in HHI in each market well above the 100 point threshold.

Our HHI analysis reveals the following:

(1) *Total long distance market.* The pre-merger HHI of 2,642 indicates a highly concentrated market. The post-merger increase in the HHI of 538 creates a presumption of market power. (Table 3)

(2) *Residential long distance market.* The pre-merger HHI of 3,795 indicates a highly concentrated market. The post-merger increase in the HHI of 210 creates a presumption of market power. (Table 4)

(3) *Larger business market.* The pre-merger HHI of 2,463 indicates a highly concentrated market. The post-merger increase in the HHI of 618 creates a presumption of market power. (Table 5)

[28] U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines (*Apr. 2, 1992 as revised Apr. 8, 1997), § 1.51.

(4) *Larger business ATM and Frame Relay market.* The pre-merger HHI of 3,313 indicates a highly concentrated market. The post-merger increase in the HHI of 1,118 creates a presumption of market power. (Table 6)

Table 3. Total Long Distance Market Shares, 1998
based on total inter-LATA toll revenues

Carrier	**1998 (Percent)**	**Pre-Merger HHI**	**Post-Merger HHI**	**Total Increase, HHI**
AT&T	43.0	1849	1849	
MCI WorldCom	25.6	655	1303	
Sprint	10.5	110		
Qwest	2.4	6	6	
Teleglobe/Excel	2.0	4	4	
Williams	1.9	4	4	
Cable & Wireless	1.0	1	1	
GTE	0.7	1	1	
Others*	12.9	12	12	
Total	**100**	**2,642**	**3,180**	**538**

Source: FCC, *Trends in Telephone Service*, Industry Analysis Division of Common Carrier Bureau, Table 11.2, Sept. 1999.

Table 4. Residential Long Distance Market Shares Nationwide, 1998

Carrier	**1998 (Percent)**	**Pre-Merger HHI**	**Post-Merger HHI**	**Total Increase, HHI**
AT&T	58.3	3399	3399	
MCI WorldCom	18.4	339	581	
Sprint	5.7	32		
Teleglobe/Excel	3.3	11	11	
Other*	14.3	14	14	

Total	**100**	**3,795**	**4,005**	**210**
Source: FCC, *Trends in Telephone Service*, Industry Analysis Division of Common Carrier Bureau, Table 11.5, Market Share of Residential Toll Revenue by State: 1998, Sept. 1999 based on PNR and Associates, Inc. *MarketShare Monitor*. * assumes none greater than 1 percent market share				

Table 5. Larger Business Long Distance Market Shares, 1998				
Carrier	**1998 (Percent)**	**Pre-Merger HHI**	**Post-Merger HHI**	**Total Increase, HHI**
AT&T	39.4	1552	1552	
MCI WorldCom	27.6	762	1505	
Sprint	11.2	125		
Qwest/LCI	2.1	4	4	
Frontier	1.6	2	2	
Cable & Wireless	1.6	2	2	
Excel/Teleglobe	0.5	0	0	
Other IXCs*	15.2	15	15	
Other LECs*	0.9	1	1	
Total	**100**	**2,463**	**3,081**	**618**
Source: Statement of James F. Rill, Hearing on Issues Relating to the Proposed MCI WorldCom/Sprint Merger, U.S. Senate Committee on the Judiciary (Nov. 4, 1999) based on date in Dataquest, “Public Telecommunications Services North America Market Share and Forecast” (1999). * assumes none greater than 1 percent market share				

Table 6. Larger Business Frame Relay and ATM Market Shares, 1998 domestic and international long distance frame relay and ATM revenues				
Carrier	**1998 (Percent)**	**Pre-Merger HHI**	**Post-Merger HHI**	**Total Increase, HHI**
AT&T	46.0	2116	2116	
MCI WorldCom	27.0	729	2275	

Sprint	20.7	428		
Other*	6.3	40	40	
Total	**100**	**3,313**	**4,431**	**1,118**

Source: "Users blast WorldCom merger," *Network Fusion* (Oct. 11, 1999) based on data from IDC, MCI WorldCom, Sprint (available at http://www.nwfusion.com/news/1999/1011/mciworld.htm, downloaded Dec. 6, 1999)
* assumes none greater than 1 percent market share

b. Industry Market Trends

i. The State of Long Distance Competition Today

The proposed merger should be analyzed against an accurate picture of the state of competition in the long distance industry today. In many market segments, competition is <u>not</u> thriving, and overall, prices are not falling at the same rate as declining costs.

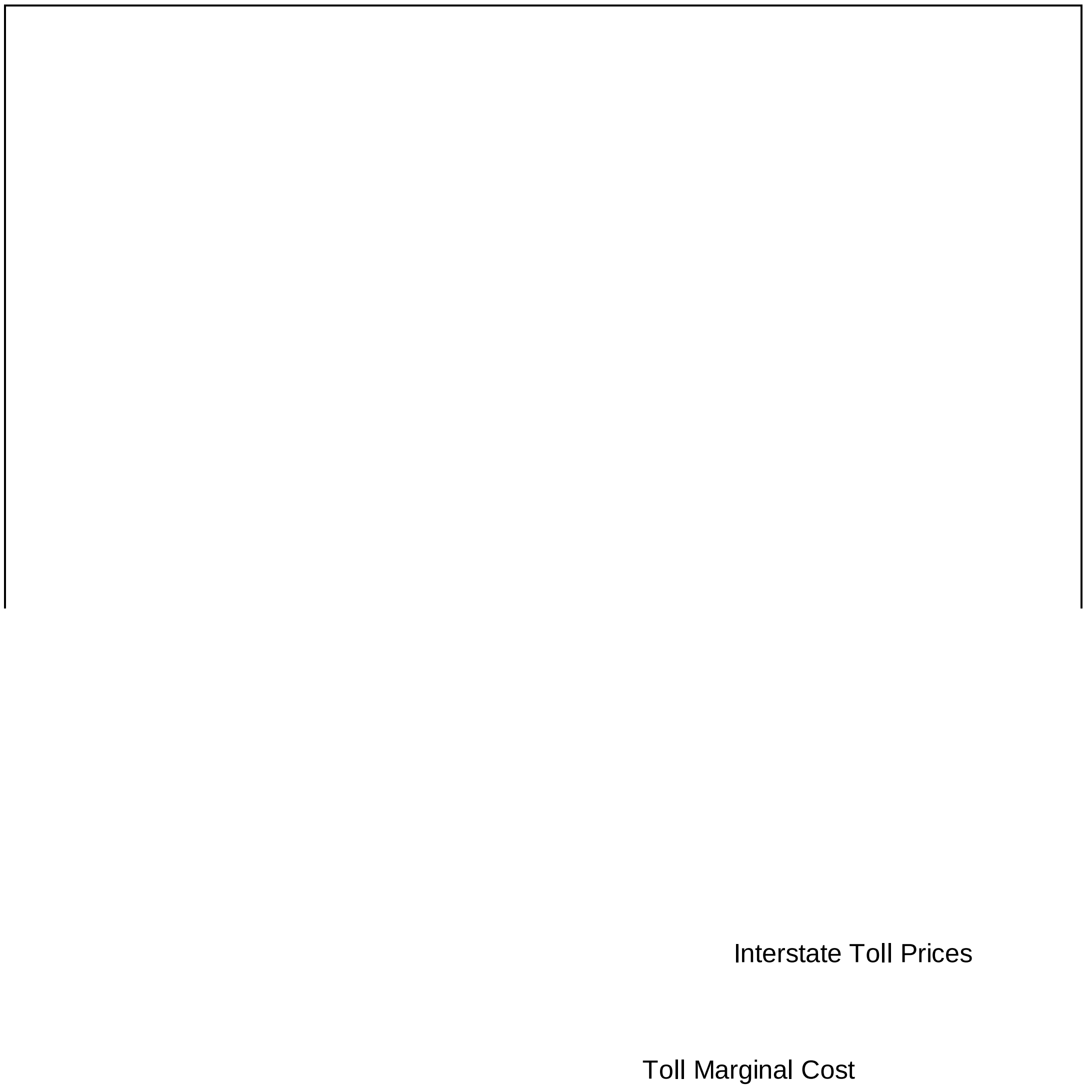
First, long distance companies are not competing to serve low-volume long distance consumers, who comprise approximately 50 percent of residential households. In fact, long distance rates are largely flat for this market segment.[29]

In the overall long distance market, rates are not falling at the same rate as declining costs. According to the Bureau of Labor Statistics, the incremental cost of long distance service has

[29] Reply Comments of Consumer Federation of America, Consumers Union and the Texas Office of the Public Utility Counsel, *In the Matter of Low-Volume Long-Distance Users*, CC Docket 99-249 (Oct. 20, 1999) at 18-19 and Exhibit 3 at 28 (*Reply Comments of Consumer Federation of America*, CC Docket 99-249).

declined 40 percent since 1996.[30] Yet, the average price for long distance service (as measured by the consumer price index) has declined only 5.8 percent. (See chart 1.)

[30] Bureau of Labor Statistics, unpublished figures. The decline in the incremental cost of long distance service can be explained largely by access charge reductions and the lower cost of long distance transport and transmission.



Source: Bureau of Labor Statistics; Interstate Toll Price = CPI for interstate toll

Competition is not driving down long distance rates commensurate with the decline in the incremental cost of a long distance call. The increased market concentration that would result from the proposed merger would create even greater incentive and opportunity for the remaining market participants to set prices at anti-competitive levels, and continued failure to pass along long distance savings to consumers based on declining costs.

ii. MCI WorldCom and Sprint as "Second Choice" Alternatives

The DOJ *Horizontal Merger Guidelines* note that consumers are likely to be "adversely affected" by a merger if the two merging carriers are the second choice for each other. In other words, if a dissatisfied MCI WorldCom customer is more likely to switch service to Sprint than to AT&T (or to another smaller long distance carrier), then the presumptive anti-competitive impact of the merger already identified in our HHI analysis takes on even more weight.[31]

Many consumers see Sprint as their second choice long distance carrier to MCI WorldCom. The Commission had already received a significant number of letters from small business and residential consumers indicating their concern that the proposed merger would eliminate their "second choice" alternative in the long distance market. Many of these letters are from former MCI customers who switched to Sprint after they experienced degraded service after WorldCom merged with MCI. We cite two letters, the first from the director of operations of a small electronics business in Herndon, Va., and the second from a residential customer in Refugio, Tx.

> 1. *Small business customer in Herndon, Va.:* "As a small business and office, we chose MCI telecommunications services when we moved to our current location in January 1997. We were quite happy with MCI for some time. <u>But, as MCI grew, their service seemed to deteriorate and their rates to us grew. Since the beginning of 1999 we have</u>

[31] "Where market concentration data fall outside the safe harbor regions of Section 1.5 (e.g. concentration above 1800 and change in HHI above 100), the merging firms have a combined market share of at least thirty-five percent, and where data on product attributes and relative product appeal show that a significant share of purchasers of one merging product regard the other as their second choice, then market share data may be relied upon to demonstrate that there is a significant share of sales accounted for by consumers who would be adversely affected by the merger." *DOJ Horizontal Merger Guidelines*, §1.211.

> experienced poor service and increasing charges. We complained to MCI for several months to no avail, so decided to get quotes from other long distance companies. Our initial assessment of AT&T, Sprint, and MCI led to several meetings with Sprint representatives. After some negotiation, Sprint was able to offer the services we needed at the best rate...
> We decided to switch our service over to Sprint, and almost immediately thereafter, the potential merger with MCI/WorldCom was announced.
>
> From our experiences of the past 6 months, it is obvious this merger will lower competition for long distance telephone service for small businesses. While it seems there are many services out there, in reality for the small business market there are not many options. We would be hard put to find the kind of multi-faceted service we need outside of the three large suppliers. If Sprint is allowed to merge into MCI, it seems inevitable that rates for small businesses, like ours, will rise. Neither AT&T nor MCI would quote us comparable rates to those we received from Sprint...[32] (emphasis added)
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> 2. *Residential consumer in Refugio, Tx.:* I have long distance and digital PCS phone service with Sprint. I like the way Sprint does things...I used to have long distance with MCI. I changed to Sprint because I didn't like the way they treated me as a customer, and because Sprint offered a better deal. Now what's going to happen in a merger. Will it be like MCI was?..The company will be too massive to be consumer-friendly.[33] (emphasis added)

iii. Lock-Step Pricing

The Big Three engage in lock-step pricing, with Sprint (first) and MCI WorldCom (second) serving as the price leaders.[34] (See chart 2 in Appendix xx.) The reduction of the Big Three to the Big Two will facilitate the opportunity and create incentive for coordinated action among the

[32] *Ex Parte* Letter to FCC Chairman William Kennard from Ronald Gedney (Director of Operations, National Electronics Manufacturing Initiative, Inc., Herndon, Va.) CC Docket No. 99-333 (Nov. 5, 1999).

[33] *Ex Parte* E-Mail to FCC from Molly S. Allday (Refugio, Tx.) CC Docket No. 99-333 (Nov. 4, 1999).

remaining two dominant long distance carriers to set prices, degrade service, or reduce innovation in products and services at anti-competitive levels.

[34] Attachments to Testimony of James F. Rill (Nov. 4, 1999).

Contrary to the assertions of the Applicants, pre-paid calling cards and the availability of dial-around options do not serve to provide competitive constraint to the lock-step pricing policies of the Big Three. The Telecommunications Research and Action Center (TRAC) analyzed rates for 13 different dial-around plans. Most of the dial-arounds charge 10 cents a minute; those with lower per-minute rates were only for first-time users for a preliminary period or charged a minimum per-call fee that essentially raised the per-minute rate above 10 cents per minute.[35]

Morever, consumer organizations note that consumers venturing into the world of dial-arounds and pre-paid calling cards must navigate through a treacherous landscape of additional fees, confusing rate formulas, and a huge range in prices. Such research is "unwieldily if not totally impractical option for consumers."[36] With pre-paid calling cards, consumers face difficulty determining the actual rate per minute. In a New York Attorney General's Office study, the per minute rates for a sample of prepaid calling cards ranged from 9 cents a minute to 57 a minute, with the average around 31 cents a minute.[37]

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[35] Telecommunications Research and Action Center (TRAC), "Dial-Around Comparison Survey" (Nov. 1999).

[36] *Reply Comments of Consumer Federation of America*, CC Docket 99-249 at 20-22.

[37] *Id.* at 22, *citation* from Eliot Spitzer, Attorney General of the State of New York, Bureau of Consumer Frauds and Protection, "Pre-Paid Phone Cards: The Facts," Table 5 (The NY study is available at http://www.oag.state.ny.us/family/kids/finance/phonecrd.html).

iv. There is No Alternative to the Big Three in the Larger Business Market for Advanced Services

Large business customers have expressed serious concerns about the anti-competitive impact of the proposed merger. The market for integrated voice and data services (voice, frame relay, and/or ATM) for enterprise users are served by only three companies--Sprint, MCI WorldCom, and AT&T. Together they control 98.6 percent of the ATM services market and 93.3 percent of the frame relay services market.[38] The elimination of one competitor will significantly reduce the product and service choices for enterprise users and significantly reduce price competition. Many enterprises use two vendors to maintain some network diversity. In those situations, having three competitors is essential to maintaining price competition in the selection process.

Corporate enterprise users view the merger with Sprint as the demise of one quality alternative. According to one on-line discussion group of IT managers for large business customers, the merger announcement "crackled with denunciations of Ebbers for corralling Sprint."[39] "What we're concerned about is that it's going to mean we can't (pit) them against one another," a senior network architect from Northrop Grumman noted.[40]

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[38] David Rohde, "Users Blast WorldCom Merger: Net Integration, Customer-Service Nightmakes Feared in $115 Billion Sprint Deal," *Network World* (Oct. 11, 1999) (available at http://www.nwfusion.com/news/1999/1011mciworld.html; downloaded Dec. 6, 1999.)

[39] *Id*..

[40] George Sullivan, senior network architect at Northrop Grumman in Bethpage, N.Y., quoted in *Id*.

"Corporate users will be worse off as the Big Three become the Big Two," says a report issued by Forrester Research. "With one less national network provider, users will be faced with fewer service choices and network diversity options."[41] An analyst with Giga Information Group concurs: "This merger is negative for every single business user in the U.S. Instead of three bids for prices and network designs, you will get only two."[42] According to an analyst from Vertical Systems Group concurs: "It's going to be harder for large enterprises, particularly those that have been careful to split their traffic because they are looking for an alternative vendor."[43]

According to the Forrester Research report, the single best-positioned carrier to present itself as a third challenger to AT&T and the merged WorldCom would be Qwest. However, according to the Forrester report, Qwest is still not suited for the comprehensive voice and data long-term contracts users commonly negotiate today with the Big Three. Qwest only began offering a managed router option in July, and then only through a third-party network management house and until recently did not have an IP-based virtual private network (VPN) service. According to the Forrester report, Cable & Wireless is "still not perceived as being a national infrastructure provider" with too few points of presence, nor is Level 3 Communications a significant

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[41] Citation in David Rohde, "New No. 3 Carrier?...Not So Obvious," *Network World* (Oct. 18, 1999).

[42] Lisa Pierce, analyst with Giga Information Group Inc. in Cambridge, Ma. quoted in Matt Hamblen, "Network Managers Fear WorldCom Merger Will Reduce Bids, Harm Customer Service," *Computer World (*Oct. 11, 1999).

[43] Rosemary Cochran, analyst with Vertical Systems Group in Dedham, Ma. quoted in Stephen Lawson and Nancy Weil, "MCI - Sprint Combo Looms; Proposed Mega-Merger Draws Applause but Raises Fears," *InfoWorld (*Oct. 11, 1999).

competitor in the larger business retail market, since it aims its business primarily at other carriers as a wholesaler.[44]

v. The $30 Billion Premium: Evidence from the Capital Market of Post-Merger Anti-Competitive Pricing

The capital markets expect that a merged MCI WorldCom/Sprint would be able to derive increased margins based on the creation of an anti-competitive duopoly long distance market.

[44] David Rohde (Oct. 18, 1999) *supra n. 18*.

The capital markets expect the merger to provide an earnings boost resulting from decreased competition in the long distance market. MCI WorldCom is paying a $30.7 billion premium over pre-merger market value for Sprint's long distance operations. MCI WorldCom agreed to pay $72.8 billion for FON, the stock that tracks Sprint's wireline business, on Oct. 5, 1999. One month earlier, absent rumors of the proposed merger, FON's stock market value was $42.1 billion.[45] The difference between $72.8 billion and $42.1 billion is the $30.7 billion premium that must be justified to investors in the capital markets.

The Applicants have projected operating cost and capital expense synergies as a result of the merger. Warburg Dillon Reed, Sprint's investment advisor, estimates that the present value of the projected synergies range from $25 billion to $30 billion – the precise amount of the premium that MCI WorldCom is willing to pay for Sprint's long-distance business.[46] Therefore, the premium is justified only if <u>all</u> the anticipated synergy savings from the merger are reported as final profits – a near impossible scenario in a competitive market where prices for high-volume consumers are going down.

In a competitive market, a portion of the synergy savings would be passed on to consumers in the form of lower prices, improved services, or both. However, the elimination of a major competitor

[45] Market Watch data available at http://www.yahoo.com.

[46] Opinion of Sprint's Financial Advisor, Securities and Exchange Commission Form S-4/A filed Dec. 12, 1999.

will allow the synergy savings to flow directly to final profits and to investors--not to consumers in the form of lower prices or higher quality services. This is the market logic among investors that supports the $30 billion premium that WorldCom is paying for Sprint's long distance business.

In fact, leading financial analysts calculate that pre-tax profit margins for the combined MCI WorldCom/Sprint will be higher than the profit margins of the separate companies. According to a Paine Webber analysis, pre-tax margins would be as follows: WorldCom (40 percent), Sprint (36 percent), and a combined WorldCom/Sprint (42 percent).[47] This is further evidence of the merged entities' ability to set long distance prices or degrade services at anti-competitive levels in order to achieve even higher margins.

vi. Barriers to Entry and Expansion

According to the DOJ *Horizontal Merger Guidelines*, market entry that is "timely, likely, and sufficient in its magnitude, character and scope" may counteract the anti-competitive impact of a proposed merger.[48] The DOJ considers such entry "timely" if the committed entry alternatives "can be achieved within <u>two years</u> from initial planning to significant market impact."[49] (emphasis added)

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[47] Paine Webber Report on MCI WorldCom, Inc., Oct. 14, 1999.

[48] DOJ *Horizontal Merger Guidelines*, § 3.0.

[49] *Id.* § 3.2.

Within the two year time frame of this merger review, it is not likely that new entrants will enter the long distance market in sufficient magnitude, character, and scope to counteract the anti-competitive impact of the proposed merger. We focus in these comments on whether entry will be "timely, likely, and sufficient" to counteract the anti-competitive impact of the merger in the mass market for long distance services.

Residential and Small Business Market. In the FCC's *Bell Atlantic NYNEX Order,* the Commission identified several characteristics of a successful entrant into the mass market for telecommunications services, including the ability to attract capital, technical, operational, financial, and marketing skills. More specifically, these include technical "know how," operational infrastructure such as sales, marketing, customer service, billing and network management. For the mass market, the FCC noted that brand name recognition, a reputation for providing high quality service, existing customer relationships, or the financial resources to obtain these intangible assets were particularly essential for a successful entrant.[50]

In fact, Sprint has concurred with this view. Sprint argued before the FCC that factors such as costly and time-consuming billing, customer service, and switching systems are necessary, in addition to transport fiber capacity, for a carrier to accommodate large numbers of customers who might leave a long distance carrier due to anti-competitive behavior.[51]

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[50] *Bell Atlantic/NYNEX Order* at ¶ 42 and ¶ 62.

[51] Citation in Federal Communications Commission, *In the Matter of Motion of AT&T Corp. To be*

In the mass market for long distance services, establishing brand name recognition requires substantial investment in advertising dollars, investment that is beyond the financial resources of most new entrants. In 1998, the Big Three spent hundreds of millions of dollars each on advertising. In 1998, total advertising expenditures by AT&T were $1.4 billion,

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Reclassified as a Non-Dominant Carrier, FCC 95-427 (Oct. 23, 1995 rel) at ¶ 51. In the proceeding, Sprint argued that the possession of fiber in the ground does not automatically mean that competitors have excess capacity than can mitigate a dominant carrier's market power. According to Sprint, fiber (especially dark fiber) is only one element needed to provide interexchange service. Sprint argued that the fact that other interexchange carriers may have fiber in the ground cannot be considered an absolute constraint on a dominant carrier's pricing.

MCI WorldCom were $948 million, and Sprint were $671.8 million, placing them, respectively, as seventh, seventeenth, and thirty-first largest advertisers in the nation that year. No other long distance carrier came close to this level of expenditure. There are no other long distance carriers (besides the Big Three) listed among the top 100 advertisers in 1998 at a minimum annual advertising expenditure that year of $100 million.[52]

One gets a sense of the magnitude of resources required to establish mass market brand recognition from the magnitude of dollars that AT&T and MCI WorldCom invested in the first five months of 1999 (the most recent data that is publicly available) to advertise their “10-10" dial-around long distance numbers. During those five months alone, MCI WorldCom spent $153 million and AT&T spent $38.5 million to advertise their “10-10" long distance brands. (Annualized these figures come to $ 367.2 million for MCI and $92.4 million for AT&T.) The next closest competitors in dial-around advertising expenditures over the same five-month period were Excel Communications ($8.5 million), Vartec ($3.5 million) and One Tel ($269,000), six percent or less than MCI’s $153 million dial-around advertising expenditures.[53]

[52] “100 Leading National Advertisers, 1998,” *Advertising Age* (available at http://adage.com/cgi-bin/adage.cgi; downloaded Jan. 11, 2000).

[53] “Top 10 10-10 Long Distance Brands by Ad Spending,” *Advertising Age* (available at http://adage.com/dataplace/archives/dp371.html; downloaded Jan. 11, 2000).

Clearly, new entrants do not have hundreds of millions of dollars in cash flow to spend on advertising to achieve the brand recognition necessary to compete in the mass market for long distance services.[54] Excel's $8.5 million pales in comparison to MCI WorldCom's $153 million spent in the dial-around market alone.

The difficulty in achieving significant market share in the long distance mass market can be seen by analyzing how long it has taken non-Big Three long distance carriers to achieve even the one to two percent market share they currently have. The fourth largest long distance carrier is Qwest with 2.4 percent market share in 1998. Qwest recently bought two other long distance carriers, LCI and USLD. LCI accounts for 1.8 percent of long distance market share. LCI began operation 11 years ago in 1989. In other words, it took LCI 11 years to achieve 1.8 percent market share. USLD accounts for another 0.3 percent long distance market share. It took USLD seven years to achieve this market share.[55]

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[54] Competition in smaller geographic markets also require considerable advertising dollars. AT&T spent $78.6 million and Sprint spent $75 million for spot TV advertising in 1998; MCI WorldCom spent $157.2 million, AT&T spent $73 million, and Sprint spent 68.8 million on cable TV network advertising in 1998.

[55] FCC, *Trends in Telephone Service*, Table 11.2

Similarly, it has taken Williams three years (since 1997) to achieve 1.9 percent long distance market share; Frontier, which entered the long distance market in 1985, has one percent long distance market share; Cable & Wireless entered the long distance market in 1985 and has 1.0 percent long distance market share; and GTE, which entered the long distance market in 1997, has 0.7 percent long distance market share.[56]

Based on this evidence, it is clear that other long distance competitors--whether as re-sellers or through a combination of their own and leased transport facilities--will not be able to act as significant market participants in the long distance market, certainly within the two-year time frame of this merger review. Should MCI WorldCom and Sprint merge, no other long distance competitors would be able to lessen the severe anti-competitive impact such a duopoly would impose on mass market long distance customers.

RBOC Entry. The Joint Applicants argue that this will change with the imminent entry of the Bell Companies into the long distance market. The Joint Applicants argue that the Bell Companies have the capital, technical, operational, and financial resources and knowledge necessary to be effective competitors in the long distance market, and that they have the brand recognition and reputation for quality, reliable service to achieve significant market share in the mass market for long distance services.[57]

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[56] *Id.*

[57] *In re Applications of Sprint Corporation, Transferor, and MCI WorldCom, Inc., Transferee for Consent to Transfer Control of Corporations Holding Commission Licenses and Authorizations Pursuant to Section 214 and 310(d) of the Communications Act and Part 1, 21, 24, 25, 63, 73, 78, 90, and 101*, CC Docket No. 99-333,

Applications for Consent to Transfer Control (Nov. 17, 1999) at ¶ 23 (*Application*) .

Such arguments, while not without merit, are speculative. The key issue the Commission must consider is whether Bell Company entry into long distance meets the two-year standard of timeliness that the DOJ's *Horizontal Merger Guidelines* consider to be necessary to mitigate the considerable anti-competitive impact of the proposed merger. In fact, it does not. As of this writing, the FCC has approved only one Bell Company application for entry into long distance--Bell Atlantic in New York state.[58]

Further, since FCC approval of Bell Company entry into long distance is taking place on a state-by-state basis, it will take time before any one Bell Company is able to compete in the national long distance market. The Bell Companies enter the national long distance market as re-sellers, without a national backbone of their own. This serves as an additional factor that makes Bell Company entry neither timely, likely or sufficient in magnitude, character, and scope to counteract the anti-competitive impact of the proposed merger in long distance markets.

4. Conclusion

The proposed merger would impair competition in both the mass and larger business long distance markets. In a post-merger duopoly market, carriers would have the incentive and opportunity to raise prices, degrade service, or delay innovation. Factors other than transmission capacity--lack of competition for low-volume customers; lock-step pricing policies; Sprint as a "second choice" alternative to MCI; the high cost of brand name recognition in the mass market; the absence of alternative carriers in the larger business market--serve as effective barriers to entry and expansion

[58] As of this writing, the FCC is considering a second Bell Company 271 applicant, SBC in Texas.

by other carriers. Finally, RBOC entry will not sufficiently offset the anti-competitive impact the proposed merger within the forward-looking two-year time frame of this merger review. There is on viable remedy, requiring full and complete divestiture of the Applicants' integrated long distance and Internet business, networks, and customers.

B. The Merger Will Result in Anti-Competitive Harm in the Internet Backbone Market

The proposed merger would also adversely affect competition in the Internet backbone market. The proposed merger would combine the largest and second largest Internet backbone carriers with combined market share of more than 50 percent. Under similar market conditions, the U.S. Department of Justice (DOJ) and the European Commission (EC) required MCI to sell its entire Internet business prior to approval of the MCI WorldCom merger. MCI sold its Internet business to Cable & Wireless for $1.75 billion.[59]

At that time, Sprint supported the spin-off. In comments to the FCC, Sprint noted that "the Commission should require as a condition of the WorldCom/MCI merger that the merging parties spin off either WorldCom's or MCI's Internet assets."[60] In applauding the European Commission's decision to launch a full investigation into the impact of the proposed MCI WorldCom merger on competition in the Internet backbone market, Sprint noted that the

[59] For a description of that divestiture agreement, see *WorldCom/MCI Order* at ¶ 151.

[60] Sprint Corporation Comments to FCC, *In the Matter of Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc*., CC Docket 97-211 (Mar. 13, 1998).

"MCI/WorldCom merger . . . raises serious anti-competitive issues" which would "short-circuit the growth of the global information network."[61]

[61] Sprint Press Release (Mar. 4, 1998).

In their Internet Submission, the Applicants have indicated to this Commission their willingness to work with policymakers to address and resolve concerns regarding Sprint's Internet backbone business.[62] To preserve a "competitive, accessible" Internet "devoid of entry barriers"[63] it is imperative that federal regulators devise an effective remedy. The MCI Internet divestiture was not an effective remedy. The market share of the divested Internet business tumbled from MCI's pre-divestiture 40 percent market share to Cable & Wireless's six to nine percent market share.[64] Based on the Cable & Wireless experience, it appears that it is not possible to achieve an effective spin-off when the divested carrier's Internet business, networks, and customer relationships are fully integrated with its other telecommunications networks, businesses, and customer relationships. This was the case with MCI Internet, and it is also the case with Sprint.

There is one viable remedy, which would require a full and complete divestiture of Sprint's integrated Internet and long distance business, networks, and customers. This remedy would at the same time resolve merger-related anti-competitive problems in long distance and Internet markets.

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[62] MCI WorldCom and Sprint, Supplemental Internet Submission, CC Docket No. 99-333 (Jan. 14, 2000), at ¶ 1. (*Internet Submission*).

[63] *WorldCom/MCI Order* at ¶ 142.

[64] *Boardwatch,* June 1997 for MCI's pre-divestiture market share; *Internet Submission*, Attachment 3 (Cahners In-Stat Group) and Attachment 5 (Sanford Bernstein) for Cable & Wireless' post-divestiture market share.

1. Relevant Market

The relevant product market for competitive analysis is the Internet backbone market. The Applicants appear to acknowledge that there is a distinct Internet backbone market.

According to the Commission's findings in the *WorldCom/MCI Order*, the Internet is an interconnected network of packet-switched networks. There are three classes of participants on the Internet: end users, Internet service providers (ISPs), and Internet backbone providers (IBPs). End users send and receive information; ISPs allow end users to access Internet backbones; and IBPs route traffic between ISPs and interconnect with other IBPs.[65]

The Commission states that the essential service provided by IBPs is transmission of information between all users of the Internet. Although IBPs compete with one another for ISP customers, they also cooperate through interconnection to assure that all end users have access to the full range of content and to other end users. IBPs interconnect with each other and with other ISPs either through settlements-free peering or paid transit.[66] The top-level networks achieve universal connectivity through settlements-free peering; smaller ISPs must pay transit fees to the larger networks to assure universal connectivity.

[65] *Id.* at ¶ 143.

[66] *Id.* at ¶¶ 144-145.

In the *WorldCom/MCI Order*, the Commission defined an Internet backbone service as "the transporting and routing of packets between and among ISPs and regional backbone networks."[67] The Commission noted that there "do not appear to be good demand substitutes for ISPs and regional backbone service providers to obtain national Internet access without access to IBPs."[68]

The DOJ and EC reached the same conclusion.[69] According to the DOJ, the Internet backbone is a relevant market for which there is no substitute. "Smaller regional backbone networks would not be adequate substitutes . . . because they would be dependent on [MCI/WorldCom] for Internet connectivity."[70] The EC similarly concluded that the "relevant market on which the merging parties are active is the market for the provision of top level or 'universal' Internet connectivity." The EC defined the market for "top-level or universal Internet connectivity" (i.e.,

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[67] *Id.* at ¶ 148.

[68] *Id.*

[69] Address by Constance K. Robinson, Director of Operations and Merger Enforcement, Antitrust Division, U.S. Department of Justice, "Network Effects in Telecommunications Mergers--MCI WorldCom Merger: Protecting the Future of the Internet" (Aug. 23, 1999), 9 (available at http://www.usdoj.gov/atr/public/speeches/3889.htm) (*Constance Robinson speech*).

[70] *Id.* at 9.

the Internet backbone market) as those Internet access carriers that are able to deliver complete Internet connectivity entirely on their own account. The EC concluded that "[A]pplying the hypothetical monopolist test, if the top-level networks were to act as one unit, then there is no one capable of providing an adequate substitute service in response to price increases."[71]

In sum, the Commission, the DOJ, and the EC have all concluded that the Internet backbone is a relevant product market for which there is no demand substitute.

[71] Commission Decision of 8 July 1998 declaring a concentration to be compatible with the common market and the functioning of the EEA Agreement, Case IV/M.1069 - WorldCom/MCI), (notified under document number C(1998) 1887), Official Journal L 116, 04/05/1999 at 70 (*European Commission Decision).*

In its review of the MCI/WorldCom merger, the Commission analyzed the geographic market as national.[72]

2. Most Significant Market Participants

The Applicants provide various sources of market share data to the Commission which, taken together, show that a combined MCI WorldCom/Sprint would have at least a 50 percent share of the Internet backbone market.[73] As the DOJ noted in assessing various sources for Internet backbone market share in the MCI/WorldCom merger, while "none of these measures is perfect, each of them, while resulting in different absolute numbers, exhibit[s] the same pattern."[74]

The most relevant publicly available Internet market share data for a competitive analysis of the Internet backbone market is data that calculates the percentage of ISPs connected to each

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[72] *WorldCom/MCI* at ¶ 392.

[73] *Internet Submission*, Attachments 1-5.

[74] *Constance Robinson speech* at 11. In their reviews of the MCI/WorldCom merger, the DOJ and EC compiled market share data from a variety of sources, including share of connections to ISPs, revenue figures, traffic flow, and installed capacity links. The EC found market share calculations based on number of POPs and address spaces were less reliable methods to calculate market share. For a more detailed description, see *also European Commission Decision* at ¶¶ 88-116.

backbone. The central issue in analyzing the competitive effects of a proposed merger in the Internet backbone market is whether the merger would allow one carrier to dominate the market for Internet connectivity due to the dominant size of the customer base that connects to its network.

Based on the Cahners data cited in the Applicants' Internet Submission, a merged MCI WorldCom/Sprint would connect with 54 percent of ISPs; using the Telegeography data cited in the Applicants' Internet Submission , the merged entity would connect with 47 percent of downstream ISPs.[75] Other sources report that the merged entity would have a combined Internet market share as high as 65 to 70 percent.[76]

Internet revenue figures are subject to distortion because they often include different revenue streams for different carriers. Given this caveat, the Sanford Bernstein data provided in the Internet Submission purports to calculate Internet backbone revenue from wholesale services and

[75] *Internet Submission*, Attachment 1 (data from Telegeography for winter 1998-99) and Attachment 3 (data from Cahners In-Stat Group for 1998).

[76] Chuck Moozakis, "Users Wary of Mega-Deal," *Internet Week* (Oct. 11, 1999); Mary Mosquera, "Sprint Buy Gives MCI WorldCom More Muscle," *CMP Tech Web* (Oct. 15, 1999).

business dedicated and dial-up access. This data finds the merged entity's combined market share based on revenue would be 47 percent.[77]

The Applicants fail to provide the Commission with internal traffic flow data which would be necessary to resolve public interest issues. In failing to provide this essential data, the Applicants fail to meet the Commission's "burden of proof" standard for a merger review. The DOJ and EC collected traffic flow data from the large Internet backbone carriers as part of the MCI WorldCom review. The Commission, acting in concert with the DOJ (and, if relevant) the EC, should conduct a similar study in the context of this merger review.

[77] *Internet Submission*, Attachment 5 (data from Sanford Bernstein, 1999). There is no standard agreement on what constitutes "Internet backbone revenue." The data in Attachment 2 is not useful because it includes non-Internet backbone revenue.

Returning to the publicly available data cited by the Applicants, it also shows that MCI WorldCom and Sprint are the largest and second largest Internet backbone providers with MCI WorldCom by far the largest participant in the market.[78] A merged MCI WorldCom/Sprint would be more than twice as large as its nearest Internet backbone competitor.

While the Applicants note that *Boardwatch* magazine has identified 46 national Internet backbones, the data provided by the Applicants shows that all but four to five have only a small percentage of the market. It appears that today there are four to five top-tier Internet backbone providers dominated by the biggest two--MCI WorldCom and Sprint.[79]

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[78] Cahners data (% ISPs interconnected) and Sanford Bernstein data (% Internet revenue); cited in *Internet Submission*, Attachments 3 and 5.

[79] Bell Atlantic and GTE have proposed a divestiture of GTE-I/BBN in order to resolve Section 271 issues related to their proposed merger.

3. Analysis of Competitive Effects

Under similar market conditions, the DOJ and EC concluded that the proposed merger between MCI and WorldCom would threaten the competitive dynamism of the Internet. Absent the Internet divestiture, the DOJ and EC concluded that a merged MCI/WorldCom would have had more than 50 percent of the Internet backbone market, similar to the market share of a merged MCI WorldCom/Sprint, creating unacceptable anti-competitive effects on the Internet market.[80]

As was true in the MCI WorldCom case, a merged MCI WorldCom/Sprint would so dominate the customer base of interconnecting Internet users and downstream Internet Services Providers that the merged entity would have both the incentive and the ability to raise prices or degrade quality of interconnection among competing providers, stifling competition at a critical stage in Internet development.[81] The fact that competing IBPs would have difficulty obtaining settlements-free peering constitutes a "substantial barrier to entry."[82]

[80] "There is little doubt that the combined entity would hold over 50 percent of the market. The combined network would be significantly larger than * the size of its nearest competitor [Sprint] on either revenue or traffic flow, bearing in mind that the next competitor, the GTE group, is about half the size of Sprint." *EC Decision* at 114. "Post-merger market shares for Internet connectivity ranged from 40 to 75 percent, depending on what measure of market share was used." *Constance Robinson speech* at 10.

[81] "MCI WorldCom would be able to act independently of competitors by raising their costs and decreasing the quality of their service offerings." *EC Decision* at ¶ 120.

[82] *WorldCom/MCI Order* at ¶ 150.

Constance Robinson of the DOJ's Antitrust Division explained why the DOJ concluded that a divestiture was necessary to preserve a competitive, dynamic Internet.

> Prior to the MCI/WorldCom merger, no single backbone provider reached a disproportionate amount of destinations on the Internet relative to other major players. There was a rough equality, with each backbone provider depending on the other. Each backbone provider, therefore, had an incentive to support efficient interconnections because its failure to do so would have caused such a degradation of quality that it risked losing customers to the other networks. That incentive would change, however, if the two largest backbone providers were combined. But the MCI/WorldCom merger threatened to create a very large network with a huge size disparity. By representing a majority of the Internet customers, MCI/WorldCom would have been more valuable and been more important as a point of interconnection for other Internet providers, which would otherwise lose access to a great deal of the Internet. MCI/WorldCom would have far less need to depend on the other backbones than those backbones would have to depend on it. By giving MCI/WorldCom a disproportionately large customer base, the merger would have changed MCI/WorldCom's incentives from favoring compatibility toward favoring incompatibility. Recognizing this, there was widespread industry concern about the effects of the merger on peering arrangements and interconnection prices.
>
> MCI/WorldCom's changed incentives would have increased the likelihood that it would attempt to tip the market by charging existing peers for interconnection or by degrading the quality of interconnections. MCI/WorldCom would have been able to do this, either through unilateral action, or through collusion with the only remaining player with a significant market share. The disproportionate dependence that other backbones would have had on MCI/WorldCom would have given it bargaining leverage to dictate the pricing and terms of interconnection . . . .
>
> . . . . At this early, but critical stage where the development of cost-based pricing and other terms and conditions for interconnection are expected to be developed through bargaining among the industry's participants, allowing one player to achieve dominance through acquisition could have had an irreversible anti-competitive impact on this market. So we either had to try to block the merger or find another way to address our competitive concerns.
>
> . . . . Since entry was not going to constrain a dominant MCI/WorldCom, any remedy had to create a viable competitor that would replace iMCI as a principal player in the national

> backbone market. The only way this was possible was through the divestiture of MCI's entire Internet business . . . . [83]

Therefore, the DOJ and the European Commission conditioned approval of the merger between MCI and WorldCom upon the spin-off of MCI's entire Internet business to Cable & Wireless.

4. Remedy

[83] *Constance Robinson speech* at 12-14. *See also EC Decision* at ¶ ¶ 117-135.

The MCI Internet divestiture to Cable & Wireless has not achieved the stated goal of antitrust regulators to create a viable competitor to replace MCI as a principal player in the national backbone market.[84] Cable & Wireless currently has somewhere between six and nine percent of Internet backbone market share,[85] far below MCI Internet's pre-divestiture estimated 40 percent Internet backbone market share.[86] There are two possible explanations for this failure. First, MCI WorldCom apparently did not abide by all terms of the divestiture agreement. Second, the structure of the divestiture was inherently problematic. We examine the evidence for each of these two explanations in turn.

First, MCI WorldCom's may not have lived up to the terms of the divestiture agreement, making it difficult for Cable & Wireless to retain MCI Internet's former customers. MCI WorldCom's alleged violations of its commitments to the DOJ and EC include:

- Failure to transfer all personnel necessary for the operation of the former MCI Internet business at prior performance and service level standards. MCI transferred only 43 sales and sales support representatives to support more than 3,300 business customers.[87] The

[84] *Constance Robinson speech* at 13.

[85] *Internet Submission*, Attachment 3 (Cahners In-Stat Group) and Attachment 5 (Sanford Bernstein).

[86] *Boardwatch*, June 1997 for MCI's pre-divestiture market share.

[87] Testimony of Mike McTighe, Chief Executive Officer, Cable & Wireless, Global Operations before the U.S.

divestiture agreement required MCI to "transfer all employees necessary to operate the Internet business by allowing C&W to identify those individual employees from a list of approximately 1,000 employees."[88]

Senate Commerce Committee, Hearings on Telecommunications Mergers (Nov. 8, 1999) (Tighe Testimony). This testimony is the source for all the bulleted items in this list.

[88] *WorldCom/MCI Order* at ¶ 151.

- Failure to provide contract documentation and other key customer information to Cable & Wireless at closing. For example, MCI WorldCom withheld 2,000 written customer contracts half of the contracts provided to date — until at least seven months after closing.[89]

- Failure to provide necessary services, systems, and support, such as competent customer billing services.

- Failure to provide services at favorable rates.

- Failure to conduct business in the ordinary course, including the reasonable retention and solicitation of customers, prior to closing.

- Solicitation of transferred customers, in violation of the non-compete provisions. The divestiture agreement prohibited MCI WorldCom from contracting with or soliciting transferred retail dedicated access customers for 18 months, web-hosting and managed firewall services customers for six months, and transferred ISP customers to provide dedicated Internet access service (unless the ISP already purchased Internet services from WorldCom at the closing of the agreement) for two years.[90]

But, even more important, the failure of the MCI Internet divestiture to transfer its customer base to Cable & Wireless in order to create a viable competitor indicates that it may not be possible to structure an effective divestiture when a carrier's Internet business is fully integrated with its other telecommunications services.

MCI's Internet business was highly integrated with its long distance (and other) telecommunications networks and services and with personnel and facilities serving both Internet and long distance businesses. MCI Internet customers also used MCI for other

[89] *Id.*

[90] *WorldCom/MCI Order* at ¶ 151.

telecommunications services, such as long distance, local service, messaging, and pre-paid calling cards.

The Sprint Internet business is similar to MCI's Internet business in that it is fully integrated with Sprint's other telecommunications services and long distance network.

Thus, divestiture of Sprint's Internet business in the context of this merger will not resolve the merger-related anti-competitive problems in the Internet backbone market. Based on the Cable & Wireless experience, that remedy would not create a viable competitor able to sustain market share comparable to Sprint's current position in the market. There is only one viable alternative that would simultaneously resolve merger-related anti-competitive problems in both the Internet and long distance markets. This would require Sprint to divest its entire Internet and long distance operations, tied to strong enforcement mechanisms, as a condition for merger approval. This remedy would simultaneously resolve anti-competitive problems in the long distance and Internet markets.

C. The Merger Will Result in Service-Affecting Employment Cuts

The Commission has noted that its public interest review may also assess whether the merger will affect the quality of telecommunications services[91] and service-affecting employment levels.[92]

[91] *SBC/AMT Order* at ¶ 50; *WorldCom/MCI Order* at ¶ 9.

[92] In the *WorldCom/MCI Order*, the Commission considered the impact of that merger on employment. *See WorldCom/MCI* at 213. In the *SBC/AMT Order*, the Commission cited SBC's commitment to "improving service

Provision of quality telecommunications service requires a skilled, experienced, and well-trained workforce that is adequate in number to install, maintain, and repair telecommunications facilities and to provide good customer service.

It is highly likely that, absent conditions, the proposed merger will result in post-merger reductions in staffing levels that would have a negative impact on the quality of telecommunications services. Further, Sprint's local telecommunications division has had a hiring freeze on core technical jobs in Sprint's local telecommunications division for over a year. As a result, inadequate staffing in Sprint's local telecommunications division (combined with other factors that we discuss in Section IVA) has seriously compromised service quality in Sprint's local telephone operations. Commitments by the Applicants to lift the hiring freeze and increase staffing levels in Sprint's local telephone operations would provide an important merger-related public interest benefit.

1. The Merger Will Result in Decline in Telecommunications Service Quality

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quality by hiring more employees." *SBC/AMT Order* at 567. In the Puerto Rico Telephone Authority/GTE Merger, the Commission also cited employee commitments as a merger-related public interest benefit. *Puerto Rico/GTE Order* at ¶ 57.

Service-affecting employment cuts are likely be substantial after a MCI WorldCom/Sprint merger. The Applicants anticipate they will realize $1.3 billion in reduced sales, general, and administrative expenses in the first year after the merger, rising to $5.5 billion by the year 2004.[93] MCI WorldCom's president of network operations and vice president for corporate development state in their joint affidavit that they expect SG&A savings to include functions such as "sales, sales tech support, customer service, and quality control" and that there will be "initial headcount reductions . . . ."[94] According to one analyst with the market research firm Dataquest, "MCI will waste little time after closing before cutting staff to justify the deal . . . ."[95]

These anticipated employment cuts are likely to impact the quality of service customers receive from the merged entity. MCI WorldCom customers are already experiencing a serious decline in customer service as a result of the employment cuts and problems integrating the different networks and workforces after the merger between MCI and WorldCom. According to Lisa Pierce, an analyst at Giga Information Group, Inc., in Cambridge, Ma., many of her clients report

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[93] *Application*, 110 and Joint Affidavit of Wayne Rehberger and K. William Grothe, Jr., Appendix E to *Application* at 15-17 (Rehberger/Grothe Aff.). PaineWebber cites SG&A synergy savings of $5.5 billion in 2004. *See* PaineWebber Company Analysis, "MCI WorldCom, Inc." (Oct. 14, 1999).

[94] Rehberger/Grothe Aff. at 15 and 17. Rehberger and Grothe state that "initial headcount reductions will later turn to employment increases thanks to substantial revenue growth." But as CWA has already noted, the Commission should regard such claims with a great deal of skepticism based on similar unsupported claims made by MCI and WorldCom to the Commission prior to that merger.

[95] Steve Koppman, analyst with Dataquest of San Jose, Ca., *quoted in* Ted Sickinger, "Sprint Merger Will Bring Extensive Job Cuts, Analysts Agree," *Kansas City Star,* Jan. 16, 2000 at A-20.

that turnover and job cuts after the MCI WorldCom merger have resulted in numerous billing errors and installations that didn't happen.[96]

According to the network manager of a plastic distributor in St. Louis, an MCI WorldCom customer:

[96]Matt Hamblen, *supra* n 42.

> MCI WorldCom staff levels are so low that we are constantly fighting to get jobs accomplished. I constantly have orders that are wrong or haven't even been placed weeks after the request was made. The technical understanding of the network doesn't exist.[97]

The IS manager of the New York Times, another MCI WorldCom customer, complained that "their organization is still in turmoil from the acquisition of MCI" with staff turnover resulting in a negative impact on the quality of MCI's service and support to his organization.[98]

These employment-related quality problems will accelerate after an MCI WorldCom/Sprint merger. The merged entity will be under pressure to meet its multi-billion dollar SG&A cost synergies. Because dissatisfied customers will have fewer market alternatives, the merged entity will feel less constrained from meeting service-affecting cost-cutting targets through job cuts. Further, while the Applicants speculate that they do not "expect" post-merger cost synergies in Sprint's local telecommunications division and that any post-merger SG&A savings in its local operations will be "minimal,"[99] reversal of service quality problems in Sprint's local operations

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[97] Mark Collins, manager of network services and telecommunications for Bunzl USA, a plastics distributor in St. Louis *quoted in* David Rohde (Oct. 11, 1999) *supra* n. 38.

[98] Dave Brown, IS manager at the New York Times *quoted in* Stephen Lawson and Nancy Weill, "MCI - Sprint Combo Looms; Proposed Mega-Merger Draws Applause but Raises Fears," *InfoWorld* (Oct. 11, 1999).

[99] *Application*, 107-8 and Rehberger/Grothee Aff. at ¶ 6 ("We do not expect the current merger to create synergies in the form of reductions in expenditures by Sprint's incumbent local exchange carrier (ILEC) operations.") and ¶ 15 (". . . ILEC-related SG&A expenses savings will be minimal.").

require additional staffing, not the *status quo* of steady decline. (*See* Section IVA for a discussion of service quality problems in Sprint's local exchanges.)

The Applicants will undoubtedly respond to the concerns we raise with a statement that revenue growth will lead to long-term employment growth at the merged entity. The Commission should regard such claims with a great deal of skepticism. MCI WorldCom made a similar claim to the Commission during the MCI and WorldCom merger review. At that time, MCI and WorldCom stated to the Commission that the merged MCI WorldCom expected to add up to 10,000 new positions after the merger.[100] Despite these statements to the Commission, just two months after the merger, MCI WorldCom announced 3,750 layoffs, or about five percent of the MCI workforce.[101] (This was consistent with information MCI provided to the Securities and Exchange Commission soon after the merger was announced in late 1998 of its plans to eliminate 4,500 positions.)[102] According to the best publicly available information, MCI WorldCom employs 3,300 fewer employees than did MCI and WorldCom combined before the merger.[103]

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[100] *WorldCom/MCI Order* at ¶ 213 n. 619.

[101] Rebecca Blumenstein, "Layoffs Could Hit 3,750 as Ebbers Slims Down Newly Merged Carrier," *Wall Street Journal* (Dec. 10, 1998).

[102] MCI SEC Form 10-K Annual Report, April 15, 1998 (for year ended Dec. 31, 1997).

[103] MCI WorldCom employment as of Feb. 28, 1999, was 77,000. Pre-merger employment was 60,000 (MCI) and 20,300 (WorldCom) for a combined pre-merger total of 80,300. The difference is 3,300 fewer jobs. *See* SEC Forms 10-K Annual Report for MCI WorldCom for the year ended Dec. 31, 1998 (filed Mar. 30, 1999), WorldCom for the year ended Dec. 31, 1997 (filed Mar. 27, 1998), and MCI for the year ended Dec. 31, 1997 (filed Apr. 15, 1998).

Some analysts calculate higher post-merger job loss figures. Lisa Pierce of Giga Information Group calculates that 5,700 MCI employees were let go after the MCI WorldCom merger. *See* Ted Sickinger, "Sprint Merger Will Bring Extensive Job Cuts, Analysts Agree," *Kansas City Star,* Jan. 16, 2000 at A1 and A-18.

MCI WorldCom states that it has 77,521 employees, compared to a total of 73,558 employees for each company prior to the merger (excluding SHL employees since SHL was sold during the year). *See* Rehberger/Grothe Aff. at 5. Even using these figures, however, MCI WorldCom inflates its current employment figure because it includes approximately 3,600 SkyTel employees that were added to its employment figures after MCI WorldCom purchased SkyTel on Oct. 1, 1999 (after the MCI WorldCom merger). *See* SEC Form 10-K for SkyTel for the year ended Dec. 31, 1998 (filed Mar. 31, 1999). Thus, even using MCI WorldCom's figures, employment levels at MCI WorldCom due to internal growth has been virtually flat since the merger.

2. Employment Commitments

In recent ILEC merger reviews, the Commission has noted that voluntary commitments made by the merging parties to maintain or increase staffing to improve service quality enhances the public interest benefit of the merger. In the *SBC/AMT Order,* the Commission stated that "SBC has increased its commitments to improving service quality by hiring more employees . . . "[104] In the *Puerto Rico/GTE Order*, the Commission cited GTE's commitments not to make any involuntary terminations, except for cause, of PRTC employees employed on the date the sale was announced as one of the merger-related public interest benefits.[105]

[104] *SBC/AMT Order* at ¶ 567. The Commission states that SBC also increased its commitment to invest in infrastructure to improve service quality. Employment commitments were also mentioned in the merger approval orders of the Illinois and Ohio. *See* Before the Public Utilities Commission of Ohio, *In the Matter of the Joint Application of SBC Communications Inc., SBC Delaware, Inc., Ameritech Corporation, and Ameritech Ohio for Consent and Approval of a Change of Control,* Case No. 98-1082-TP-AMT; "Illinois Conditionally Okays SBC-Ameritech Merger; 3 Foes Say They Will Appeal," *State Regulation Report (*Oct. 1, 1999) at 1.

[105] *Puerto Rico/GTE Order* at ¶ 57.

In other recent ILEC mergers, merging parties have made voluntary commitments, later affirmed by state Commissions, to maintain or increase staffing to address service quality problems in the local exchange. For example, the New York Public Service Commission affirmed a commitment by Bell Atlantic/NYNEX to hire 750 to 1,000 new employees "for the purpose of addressing service quality problems"[106] and the California Public Utilities Commission affirmed SBC/Pacific Telesis' voluntary commitment to increase employment by a minimum of 1,000 jobs.[107]

In the instant proceeding, absent voluntary commitments by the merged entity to increase staffing in Sprint's local exchanges to improve service quality and (at a minimum) to maintain employment levels in other operations adequate to ensure the provision of high-quality telecommunications services, the Commission has yet another reason to find that the proposed merger would result in significant harm to consumers and is not in the public interest. Nor have the Applicants met the burden of proof standard in demonstrating public interest benefit.

IV. The Applicants Fail to Demonstrate that the Proposed Merger Will Result in Demonstrable, Verifiable, and Merger-Related Public Interest Benefits

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[106] Before the State of New York Public Service Commission, *Proceeding on Motion of the Commission as to the Joint Petition of New York Telephone Company, NYNEX Corporation, and Bell Atlantic Corporation for a Declaratory Ruling that the Commission Lacks Jurisdiction to Investigate and Approve a Proposed Merger between NYNEX and a Subsidiary of Bell Atlantic or, in the Alternative, for Approval of the Merger Petition of the New York Citizens Utility Board, the Consumer Federation of America, the American Association of Retired Persons, Consumers Union, Mr. Mark Green, Ms. Catherine Abate, the Long Island Consumer Energy Project and the International Brotherhood of Electrical Workers T-6 Council (collectively the "Consumer Coalition") for an Investigation of the Proposed Merger of NYNEX Corporation and Bell Atlantic Corporation*, Cases 96-C-0603 and 96-C-0599, Order Approving Proposed Merger Subject to Conditions (Mar. 21, 1997).

[107] Before the California Public Utilities Commission, *In the Matter of the Joint Application of Pacific Bell Telesis Group (Telesis) and SBC Communications (SBC) for SBC to Control Pacific Bell (U1001) Which Will Occur Indirectly as a Result of Telesis Merger with a Wholly-Owned Subsidiary of SBC, SBC Communications (NV) Inc.*, Order Denying Rehearing and Modifying D.97-03-067, Decision 97-11-035 (Nov. 5, 1997).

The Commission uses a "balancing process" that weighs the probable public interest harms of a proposed merger against probable public interest benefits. As harms to the public interest become greater and more certain, the degree and certainty of the public interest benefits must also increase commensurately in order for the Commission to determine that the transaction serves the public interest.[108] For some mergers, the harm to competition may be so significant that it cannot be offset sufficiently by pro-competitive commitments or efficiencies.[109]

As we discussed in Section III above, the proposed MCI WorldCom/Sprint merger would result in considerable harm to competition in long distance and Internet backbone markets and to telecommunications service quality. The Applicants must therefore show that there are strong, demonstrable, justified, and merger-related public interest benefits that would result from the proposed merger, particularly for residential and small business consumers. The Applicants fail to do so. They do not demonstrate even a minimal level of merger-related public interest benefits.

First, the Applicants fail to demonstrate that the proposed merger will benefit the one group of residential and small business consumers for whom such commitments would be readily demonstrable and justified, residential and small business consumers in Sprint's local exchange

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[108] *SBC/AMT Order* at ¶ 256; *Bell Atlantic/NYNEX Order* at ¶ 157.

[109] *Bell Atlantic/NYNEX Order* at ¶ 15.

markets. Sprint serves 7.9 million primarily rural customers in 18 states. Sprint has allowed its local exchange networks to deteriorate and is not deploying broadband technologies such as xDSL-capable loops or its ION service in its non-urban local exchanges. One strong potential public interest benefit that residential and small business consumers could derive from the proposed merger would be specific commitments by the merged entity to improve service quality and accelerate deployment of advanced services in Sprint's local wireline telecommunications networks. But on this, the Applicants are silent.

Instead, the Applicants make their case for the public interest benefits of the proposed merger by arguing that it will facilitate deployment of an as-yet unproven technology, fixed wireless (MMDS), that they claim could be a third facilities-based alternative to the home. This purported benefit is neither demonstrable nor merger-related. The Applicants' post-merger capital investment plan in MMDS is at the same level as each Applicant had planned to make separately in MMDS deployment prior to the merger announcement. There is no merger-related benefit in MMDS.

A. Consumers in Sprint's Local Telephone Operations Will Not Benefit from the Merger

1. Sprint Has Allowed its Local Telephone Operations to Deteriorate

The Applicants claim that Sprint's expertise in operating and managing local exchange systems will enable the new merged entity to expand competition and to provide benefits to consumers in local markets.[110] In fact, in recent years, Sprint Corporation has neglected its local telephone operations. Sprint has diverted local ratepayer money to finance expansion in wireless, Internet, and international operations, even as it allows its local networks to decline.

[110] *Application* at 14.

According to ARMIS service quality data provided by Sprint to the FCC, service quality in Sprint's local operations has seriously declined over the past several years. We provide service quality data for Sprint's three largest local telephone operations Nevada, Florida, and North Carolina, which together represent 55 percent of Sprint's access lines[111] from 1996 to 1998 (the most recent year for which FCC data is available).[112]

<u>Nevada</u>[113] (Where access lines increased 16 percent, 1996-1998)
Service outages increased 56 percent, up from 62,400 to 97,700.
Repeat service outages increased 74 percent, up from 8,400 to 14,700.
Trouble reports increased 29 percent, up from 151,100 to 195,600.
Repeat trouble reports increased 32 percent, up from 21,300 to 28,100.

<u>North Carolina</u>[114] (Where access lines increased 18 percent, 1996-1998)
Service outages increased 66 percent, up from 121,800 to 202,000.
Repeat service outages increased 63 percent, up from 12,700 to 20,700.
Trouble reports increased 51 percent, up from 173,700 to 262,000.
Repeat trouble reports increased 47 percent, up from 18,400 to 27,000.

<u>Florida</u> (Where access lines increased 41 percent, 1996-1998)
Service outages increased 68 percent, up from 204,300 to 343,200.
Repeat service outages increased 108 percent, up from 18,200 to 38,000.
Trouble reports increased 67 percent, up from 264,100 to 440,700.
Repeat trouble reports increased 101 percent, up from 24,500 to 49,400.

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[111] *Id.*, 25.

[112] All data from Federal Communications Commission, Armis Report, Table 43-05, various years.

[113] The FCC data for Nevada also includes data for a very small Sprint telephone company in North Carolina.

[114] Carolina Tel & Tel (Sprint's largest local telephone company in North Carolina).

What accounts for this disturbing decline in service quality in Sprint's local telephone operations over the past three years? The answer can be found in an examination of cash flow between Sprint's local telephone companies and the holding company over the same period. Sprint has been using local ratepayer money to finance investments in its non-local telephone lines of business rather than re-investing it to maintain and to upgrade its local telephone networks.

Based on data provided by Sprint to the Commission, we trace the flow of dividend payments from Sprint's local telephone operations to Sprint Corporation (the holding company). We find that over the past three years (1996-1998), Sprint Corporation used $1.4 billion in local ratepayer money to subsidize corporate dividend payments and to finance non-local telephone operations.[115] This is money that otherwise would have been available to the local telephone companies for investment in the local network.[116] (A description of the methodology we use to arrive at these figures can be found in Appendix E.)

[115] CWA calculation based on data in FCC, *Statistics of Communications Common Carriers,* Table 2.9, various years. Over the 1996-98 period, Sprint Corporation used $207.6 million in (North) Carolina Tel & Tel ratepayer money, $391.5 million in Nevada ratepayer money, and $294.7 million in Florida ratepayer money to subsidize corporate dividend payments or to finance non-local telephone operations. In 1998, for example, (North) Carolina Tel & Tel sent $92.5 million in dividend payments to Sprint Corporation, an amount which exceeded (North) Carolina Tel & Tel's $74.8 million profits that year by $17.7 million.

[116] The Applicants will likely respond that it is sound business practice to use internal resources from mature lines of business to finance expansion and growth. CWA does not dispute this. The issue, however, is one of degree.

As a result of Sprint's corporate policy to use local ratepayer money to subsidize corporate dividend payments and to finance its expansion into non-local telephone operations, Sprint has reduced operating and capital budgets in its local telephone operations. According to reports from CWA leaders who represent more than 5,000 employees in Sprint's local telephone companies in 12 states where Sprint has local operations, evidence of declining service quality derives from the following corporate policies:

Sprint used resources generated by ratepayers in its monopoly local exchange operations to generate $1.4 billion over a three-year period to finance non-local telephone operations.

- **Sprint has cut employment levels far below those needed to do the work.** Sprint corporate policy will not allow local managers to hire technicians to fill vacant positions. Sprint imposed a hiring freeze on key technical positions in its local telecommunications division in February 1999 that is still in effect today, 12 months later. According to a Sprint bulletin of the Local Telecommunications Division dated Feb. 4, 1999, "jobs of departing LTD [local telecommunications division] employees will not be backfilled."[117] (A copy of the document is in Appendix D.) Because there are fewer technicians available to install new lines and repair troubles, consumers experience longer service delays.

- **Sprint has all but abandoned preventive maintenance of the network.** Because there are not enough technicians, Sprint has disbanded preventive maintenance crews and redeployed the workers to installation and repair. This is not a temporary situation limited to a few locales; CWA has confirmed that Sprint disbanded preventive maintenance crews in many of Sprint's local telephone operations and that this situation has existed for six months to more than two years in some places.

- **Local operating budgets have been drastically reduced.** The annual budget to repair faulty cable frequently runs out in the first or second quarter of the year. The situation is likely to get worse; a Vice-President in Sprint's local telecommunications division has set a goal of 10 percent reduction in operating costs by 2001. (*See* Appendix D.)

- **Sprint has allowed its outside plant to deteriorate and is not investing in new facilities.** Sprint is not putting in new cable to replace dilapidated sections. In addition, neighborhoods are running out of copper pairs. As a result, when a technician goes in to fix a trouble or install a new line, there are no good pairs left. So the technician "frogs" a pair, moving other customers onto other lines, trying to find a halfway decent pair. Inevitably, the technician is back again with a repeat trouble or another trouble report on the "frogged" line.

- **Sprint pushes technicians to make quick fixes rather than to remedy the underlying problem.** If a customer calls in with a problem, the Sprint technician is told to fix only that customer's pair, even if the technician discovers that the source of the problem is faulty cable serving many households or connecting central offices. Because the technician has not been allowed to fix the real problem, the tech is back again soon with a repeat trouble or trouble on another pair served by the same cable.

- **Sprint gives priority service to its most profitable customers.** Sprint instructs its employees to provide better service to targeted customers--those who account for a disproportionate share of Sprint profits--and who therefore should expect to receive the best possible treatment.

[117] Sprint bulletin, "Temporary Hiring and Employee Transfer Restrictions" (Feb. 4, 1999).

- **Sprint does not authorize overtime to ensure timely customer service.** In mid-October, 1999, just two weeks after the proposed merger was announced, Sprint's Local Telecommunications Division issued new overtime guidelines which drastically reduced the authority of local managers to use overtime to resolve customer service outages and troubles. As a result, Sprint will not authorize overtime even for out-of-service calls on lines affecting up to 89 customers, which means customers whose line goes down on a Friday must wait until Monday to get service restored. (A copy of the new overtime guidelines is in Appendix D.)

- **Contractors create costly service problems.** Because Sprint has imposed a company-wide hiring freeze in its local telephone operations, Sprint uses less-skilled, inadequately trained, poorly equipped and yet often more expensive contractors who create new problems. Sprint technicians then must come in and clean up the work.

2. Sprint Is Not Investing in Advanced Services in its Rural Local Exchanges

A key goal of the Telecommunications Act of 1996 is to encourage the deployment of advanced telecommunications and information services in all regions of the country.[118] Yet, Sprint is not deploying broadband technologies in the local loop in its non-urban local markets. In the Applicants' filing, they detail no concrete plans to change this and provide broadband technology to Sprint's non-urban markets.

[118] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *codified at* 47 U.S.C. § 254(b)(2) (1996 Act).

Sprint does not offer DSL service in 15 of the 18 states in which it provides local service.[119] Sprint has announced plans to roll out DSL service in only three urban markets: Charlottesville, Va.; Las Vegas, Nv.; and Orlando, Fl. As of August 1999, Sprint was offering DSL to residential customers in only one of those markets, Charlottesville, Va.[120] Sprint ION is being rolled out in three cities: Denver, Kansas City, and Seattle.[121] Absent conditions, Sprint's primarily rural local exchange customers are likely to wait years for access to high-speed Internet connectivity.

3. The Merger Will Not Result in Increased Investment in Sprint's Local Telephone Markets

Consumers in Sprint's local markets can expect continued deterioration of service after the merger. The Applicants have provided the Commission with no evidence of business plans to increase investment in Sprint's local telephone operations. Nor have the Applicants provided the Commission with evidence that the merged entity will invest in broadband serving Sprint's rural and suburban local markets.

[119] Sprint Website (http://www.sprint.com/data/dsl).

[120] Sprint Press Release, "Sprint Brings High Speed DSL Service and Earthlink Sprint Internet Access to Las Vegas" (Aug. 16, 1999) (available at http://www.sprint.com/Stemp/press/releases/199908/19908160847.htm).

[121] Sprint Press Release, "Sprint Begins Marketing Sprint ION Services in Denber, Kansas City, and Seattle" (Nov. 11, 1999) (available at http://www.sprint.com/Stemp/press/releasese/199911/199911110896.htm).

The Commission should not be reassured by the Applicants claim that they do not “expect” to realize cost synergies in Sprint’s local operations. In fact, it appears that since the merger announcement, Sprint’s Local Telecommunications Division has accelerated its cost-cutting plans. In November 1999, just seven weeks after the merger agreement, a senior vice-president in Sprint’s local telecommunications division announced a goal to reduce operating costs in Sprint’s local operations by 10 percent across the board in the year 2001 (the year that the proposed merger would take effect if it receives all necessary regulatory approvals.)[122] (*See* Appendix D.)

Financial analysts predict that the merged new WorldCom will place less focus on the consumer business, including its local telephone operations. Jack Grubman, telecommunications analyst with Salmon Smith Barney and financial advisor to MCI WorldCom, recently wrote that MCI WorldCom will shift out of businesses that have minimal long-term growth potential, such as some consumer businesses or the wholesale voice business. Mr. Grubman noted that over time MCI WorldCom’s mix of revenues will focus on more profitable, faster-growing businesses such as data, Internet, and international services.[123]

This is certainly consistent with MCI WorldCom’s strategic focus on the business market. In a May 1999 interview, John Sidgmore, MCI WorldCom’s vice chairman made clear that MCI WorldCom’s focus is on the business customer:

[122] A Message from Bill McDonald, Senior Vice President, CSO, LTD (Nov. 11, 1999).

[123] “MCI WorldCom Drops as Forecast Trimmed,” Yahoo Business Headlines (Jan. 6, 2000) (available at http://dailynews.yahoo.com/h/nm/20000106/bs/telecoms_mciworldcom_1.html)

> Reporter: “Will MCI WorldCom stick with its current business-to-business focus?”
>
> John Sidgmore: “Well, we have a consumer division that sells consumers long-distance like everyone else. And we’re going to keep that up. But we are not going to build out the entire country in rural areas and so forth for local access to support consumer business, which is what AT&T seems to be doing with its cable force. We’re going to put more of our capital in the center cities and the major suburban areas.”[124]

4. Conditions

The Applicants have failed to demonstrate that the proposed merger would result in benefits to residential and small business consumers in Sprint’s largely rural local telecommunications division. However, should the Applicants proffer specific, verifiable commitments to invest in infrastructure, hire more employees, adopt enhanced operating procedures, and accelerate deployment of advanced services to underserved communities in Sprint’s local telecommunications markets, the Applicants would have made significant progress in demonstrating a verifiable and merger-related public interest benefit.

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[124] *Tele.com*. (May 17, 1999).

In the *SBC/AMT Order,* the Commission concluded that the Applicants' voluntary commitment to specific actions to improve residential phone service and to accelerate deployment of advanced services to underserved communities (among other things) constituted merger-related public interest benefits. The Commission noted that these commitments contribute to the goals that flow from the Commission's statutory objectives to promote rapid deployment of advanced services and to ensure that the public has access to efficient, high-quality telecommunications services.[125]

The Applicants would demonstrate merger-related public interest benefits were they to make specific commitments to increase infrastructure investment, hire more employees to improve service quality, and accelerate deployment of advanced services to Sprint's local telephone customers.

B. The Merger Is Not Necessary to Accelerate MMDS Deployment as a Third Alternative for Consumers in the Local Exchange

[125] *SBC/AMT Order* at ¶ 355.

The Applicants claim that the proposed merger will speed the deployment of MMDS (fixed wireless) technology as a "third wire" in the local exchange, thereby enhancing consumer choice in local markets.[126] But here, too, the Applicants fail to prove this is a demonstrable, verifiable, and merger-related benefit, especially for <u>residential</u> consumers.

[126] *Application* at 89.

First, most analysts see MMDS primarily as an unproven technology which, if successful, will primarily be deployed to connect small- and medium-sized businesses to the Internet. International Data Corp. forecasts that "over the next five years, small and medium-sized businesses will emerge as the primary market for services delivered via broadband wireless technologies," with business accounting for 70 percent of MMDS revenue by the year 2003.[127] Even if new technologies resolve current line-of-sight and weather problems,[128] most analysts do not see MMDS as a practical alternative for voice transmission.[129] MMDS technology, if and when it is commercially viable, will be limited to provision of Internet access. Thus, MMDS is not a full-service facilities-based alternative in the local market.

Second, MMDS at present is still far too expensive to provide a mass market alternative to wireline technologies for residential consumers. Cisco Systems, one of the leading developers of a new MMDS technology, predicts it will get the cost of a home transceiver for MMDS down to $500 by June of this year. [130]

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[127] International Data Corp., *US Broadband Fixed Wireless Market Assessment and Forecast, 1998-2003*, released December 1994 (IDC Report) *cited in* Sherman Friedman, "Market for Broadband Fixed Wireless to Grow," *Newsbytes (*Dec. 14, 1999) (citation available at http://www.newsbytes.com).

[128] "The problem with MMDS technology is that it's mostly untested and has serious line-of-sight and weather related problems." Karekin Jelalian, "Will WorldCom's Vorcious Appetite Eat Up Broadband?", *Intelligent Network News* (Nov. 24, 1999). ". . . MMDS and other spectrum tiers still have many issues to resolve before they succeed in challenging wireline competitors." *See also* Fred Dawson, "MMDS Systems Creep Forward," *Multichannel News* (Nov. 22, 1999), 35.

[129] "The early focus [of MMDS] is going to be high-speed Internet." Ian Stokell, "US Wireless Broadband to Soar - Strategis Report," *Newsbytes* (Dec. 6, 1999). "The service is being touted as an inexpensive way to connect computer systems for medium- and small businesses and an alternative high-speed connection for homes." Cliff Edwards, "Cisco Has News Wireless Strategy," *AP Online* (Dec. 1, 1999).

[130] Cliff Edwards.

Third, the Applicants also fail to demonstrate that accelerated deployment of MMDS is a merger-related benefit. Prior to the merger announcement, both MCI WorldCom and Sprint had each invested heavily--$2 billion total--to purchase companies with MMDS licenses. Separately and independently, MCI WorldCom and Sprint had determined that these MMDS investments were justified. There is no change in their investment plans as a result of the merger.

The merged entity does not plan to increase the relatively small $200- $300 million annual investment that each company had independently planned to make in MMDS prior to the merger announcement. According to a Paine Webber analysis, the new WorldCom's MMDS "investment will take place within the parameters of the companies' previous guidance of $200-300 million per year each in investment for the MMDS opportunity." [131]

[131] Paine Webber, *MCI WorldCom Inc.*, Oct. 14, 1999 at 5.

The Applicants claim that the merger will provide the scale and scope economies necessary to deploy MMDS on a national scale.[132] However, at this stage of MMDS development, it is not clear that it is necessary to deploy a national MMDS network. MMDS is a technology that provides end-user customers Internet access. MCI WorldCom and Sprint separately could proceed to deploy MMDS networks local market by local market, much as data CLECs are doing. At this stage, they do not need nor will there be demonstrable benefits from a nationwide MMDS footprint.

Fifth, the Applicants also claim that the merger will spread the costs related to MMDS research and development, development of equipment, software development, and other related costs over a larger customer base, lowering unit costs.[133] However, MMDS providers, such as MCI WorldCom and Sprint, do not bear these R&D costs--the equipment vendors do. These vendors were already investing heavily in MMDS research and development prior to the merger announcement, anticipating return on this investment from multiple carriers (including AT&T which has also announced its intention to invest in MMDS where it does not have local cable networks).

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[132] *Application* at 90.

[133] *Id*.

The Applicants have not demonstrated that they need to merge to justify deployment of fixed wireless networks, which is as yet an unproven technology which is too costly to appeal to the mass market consumer.

C. There are No Merger-Related Public Interest Benefits

The Applicants fail to make their case that the merger will enhance choice of residential and small business consumers in the residential and small business market.

First, the Applicants' claim that fixed wireless MMDS will be a third alternative for consumers rings false. It is not a technology for voice transmission. It is unproven and currently too expensive for the mass market. The Applicants do not provide any evidence that they intend to increase investment in MMDS technology above the levels each Applicant had planned separately to make.

Second, the Applicants fail to provide the Commission with evidence of merger-related benefits in the one local market in which one of the Applicants currently provides local service--Sprint's local exchange markets.

The Commission is left with speculative commitments that the merger will benefit consumers with packages of bundled service offerings and enhanced ability to expand its competitive local service offerings. The Applicants have not demonstrated how this will benefit the one group of consumers for whom local competition has been slow to develop--residential and small business customers. The Applicants currently are serving that market in only one state, New York, even though other competitive carriers, including AT&T, are actively competing in many markets for residential and small business consumers.

Absent conditions, including conditions which would improve telephone service and accelerate deployment of advanced services in Sprint's local exchange markets, the Applicants have not demonstrated that there are public interest benefits from the proposed merger.

V. Conclusion

The Applicants fail to prove that the merger is in the public interest. It poses significant, irreversible, and immediate anti-competitive harm in the long distance and Internet backbone markets. It would reduce the quality of telecommunications service through employment cuts in local and long distance service. Absent extensive conditions and strong enforcement mechanisms, the Commission should deny the Applicants' merger request.

Respectfully Submitted,

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